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# Prospects for US-China Trade

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**An Intelligence Assessment**

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*October 1984*

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# Prospects for US-China Trade

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**An Intelligence Assessment**

This paper was prepared by
Office of East Asian Analysis. Comments and queries
are welcome and may be directed to the Chief,
China Division, OEA,

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# Prospects for US-China Trade

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**Key Judgments**

*Information available as of 15 August 1984 was used in this report.*

The United States is now China's third-largest trade partner and a major source of the technology, investment, and services needed for Chinese economic development. While China constitutes a major market for future sales of US goods and services, our judgment is that Beijing's prospects for expanding exports to the US market remain limited. 25X1

Textile products continue to dominate Chinese exports to the United States; through midyear they accounted for nearly half of total sales. Because of tightening restrictions on textile trade in the United States and other developed countries, China is trying to diversify its exports but has not yet been very successful. Exports of oil, oil products, and pharmaceuticals have increased substantially, but sales of most other goods have been less dramatic. 25X1

Chinese purchases of US goods have changed character. Once they were predominantly raw materials—textile fibers, grain, wood, chemicals—but an increasing share is now industrial machinery and other finished manufactures, technologies, and services. 25X1

We expect much of the growth in bilateral trade for the next few years to stem from expansion in joint ventures and other cooperative and investment relationships. China has taken several steps to open its economy to increased foreign participation. We estimate that US investment in joint ventures, offshore oil exploration, and other projects already totaled nearly $0.5 billion at the end of last year. Since then, the investment pace has probably picked up, bolstered by an active campaign by the Chinese leadership to encourage investment and by the exchange of visits by President Reagan and Premier Zhao early this year. 25X1

We believe that over the next decade and more, US long-term investment in China will generate sales of US machinery, raw materials, and services, as well as purchases of Chinese or jointly made goods. Some Chinese products may displace US exports to third-country markets, but few will have major impact on US firms. Although China will continue to try to expand the variety of its exportable commodities and to find alternative markets, we believe that textiles will still be China's principal source of foreign exchange and the OECD its principal market. 25X1





*EA 84-10178*
*October 1984*

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This means, in our view, that trade barriers will continue to plague the Sino-US relationship, making market access the preeminent economic issue to be faced in the next few years. Unless bilateral relations deteriorate considerably, we do not believe Beijing will elevate trade disputes to a level that could affect overall relations. But Chinese exports will persistently test any trade barriers, and US moves to limit Chinese exports could spark selective embargoes of US products. In addition, limits on textile trade have led China to join with other textile-exporting nations to challenge US and European protectionism; this will almost certainly cause further diplomatic tensions. 25X1

China will also continue to press for loosening of US limitations on the technologies available to it. Even though those limitations were liberalized last year, China has felt obliged to turn from US to European suppliers for some technologies. Their search for alternative suppliers also is motivated by the present inability of the United States to compete with concessional loans available from France, Belgium, Japan, and others. 25X1

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## Contents

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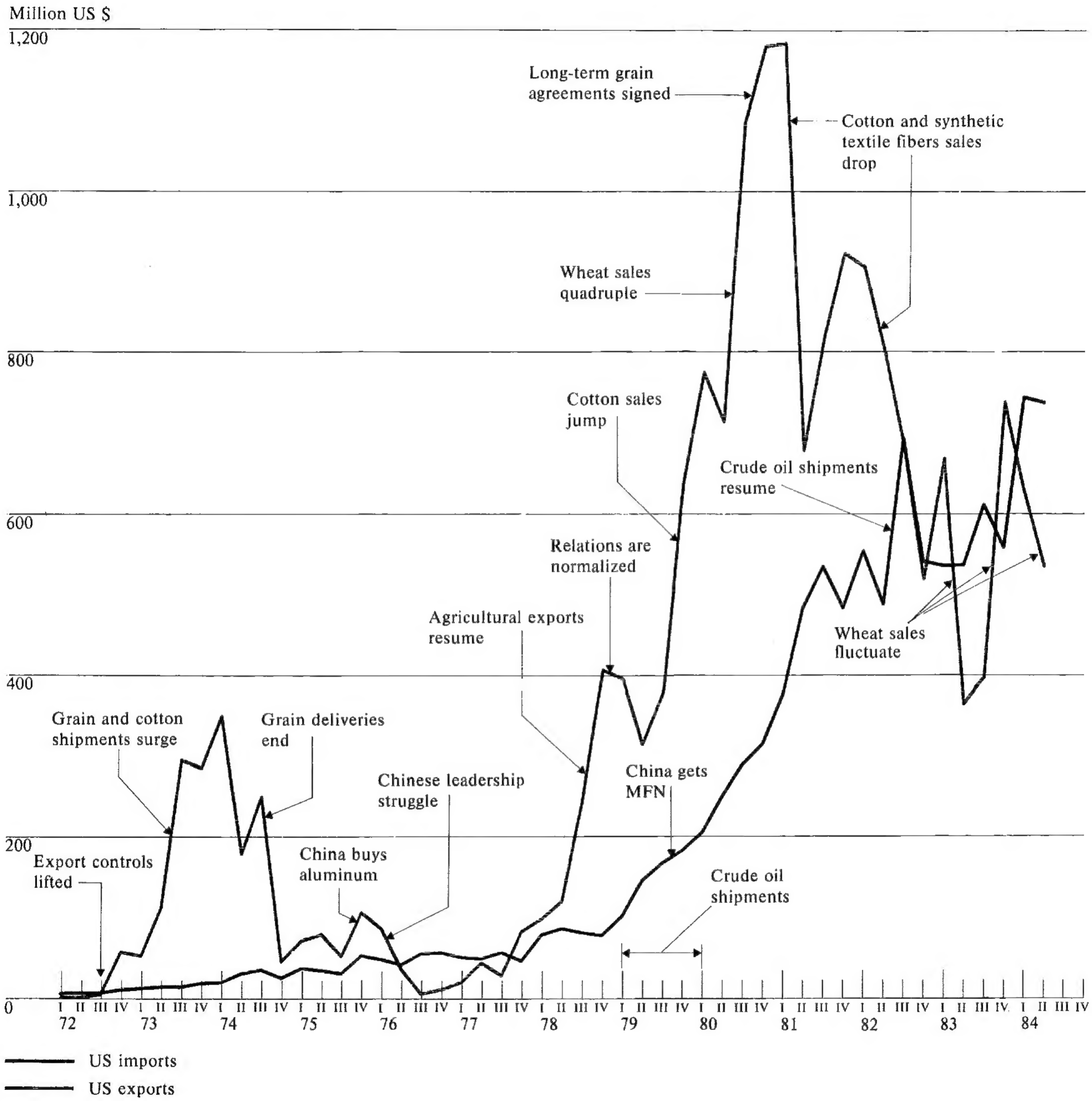
**Figure 1**
**China: Highlights of Trade With the United States, 1972-84**




Data from US Department of Commerce shows both exports and imports on an f.o.b. basis.

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# Prospects for US-China Trade

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## The US-China Trade Relationship

The United States and China have enjoyed a trade relationship for nearly 13 years. During that time, the value of two-way trade has multiplied nearly 50-fold, pushing the United States into third place among China's trade partners (see table 1). When two-way trade peaked in 1981 at $5.5 billion (see figure 1 and table 2), the United States accounted for about 14 percent of China's total, but the share slipped to 10.4 percent in 1983. China ranked 20th among US customers and 23rd among suppliers in 1983.

The relationship has not been painless. China has had to compromise many long-held principles in order to establish economic ties to the West. It has moved from a philosophy of isolated self-reliance to one of cautious cooperation. The Chinese reaction to increased openness has ranged from euphoria—highlighted by a multibillion-dollar buying spree in 1977-78—to a sullen but more realistic evaluation in 1979 of China's economic capabilities. The latest plan of development for the rest of the century proposes to use Western technology, investment, and trade to help stimulate domestic economic growth.

The past few years have seen many firsts for China: first foreign loans, first joint venture, first enterprise wholly owned by foreigners. Attempts to expand exports to the United States as rapidly as possible have yielded additional, less rewarding firsts: first antidumping complaint, first countervailing duty case. China has shown remarkable ability to marshal resources to take advantage of export opportunities; unfortunately, these have been restricted generally to narrow categories of extractive and light industries and their volume has generated trade friction. A greater diversity in its exports would alleviate some of these frictions, but will require many years of economic expansion and technological development. This paper provides a status report on recent US-China trade, a review of trends toward greater trade diversity, and a discussion of near-term prospects for further trade frictions.

## US-China Trade Patterns

### China's Exports to the United States

US purchases of Chinese goods increased steadily from 1972 to 1982 and contracted slightly in 1983. Planning Minister Song Ping told the National People's Congress in May that total trade would fall 5 percent in 1984, but preliminary statistics indicate unexpectedly strong growth in sales to US markets. The United States absorbs about 10 percent of China's total exports, ranking third behind Hong Kong (25 percent) and Japan (20 percent). Textiles and apparel dominate China's sales to the United States (see figure 2); they averaged 37 percent of total sales in 1978-82, jumped to 45 percent in 1983, and hit 46 percent in the first half of 1984. The United States is the second-largest importer of Chinese textile products, surpassed only by Hong Kong. 25X1

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Beijing has tried to diversify its exports in response to world restrictions on trade in textile products. So far, however, diversification of exports to the United States has been largely within the textile and apparel sectors—from sensitive categories to those not yet restricted—rather than into other industries. Plans to increase textile export value by selling higher value products have not been successful; the average price per unit has fallen steadily from 1981 through mid-1984. Only oil and oil products have gained significantly since 1978 and last year represented 19 percent of US imports (see table 3). 25X1

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Because of increases in sales of textiles, apparel, and oil products, China's exports to the United States have actually become more concentrated [1] among

[1] Lorenz curve techniques permit an evaluation of China's trade diversity. For exports, three-digit SITC commodities were ranked in terms of the amount of the foreign exchange earned by them, and cumulative earnings shares are measured on the vertical axis. A diagonal across the Lorenz box would indicate that an equal amount of foreign exchange was earned by each three-digit commodity group. For imports, foreign exchange expenditures were used in a comparable procedure. 25X1

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**Table 1**
**Trade Partner Rankings, 1983** [a]

*Billion US $, f.o.b.*

| Exports | | | Imports | | |
|---|---|---|---|---|---|
| Rank | Country | Value | Rank | Country | Value |
| **China** | | | | | |
| 1 | Hong Kong | 5.8 | 1 | Japan | 4.9 |
| 2 | Japan | 4.8 | 2 | Hong Kong | 2.5 |
| 3 | United States | 2.3 | 3 | United States | 2.2 |
| **United States** | | | | | |
| 1 | Canada | 37.0 | 1 | Canada | 52.1 |
| 2 | Japan | 21.6 | 2 | Japan | 41.2 |
| 3 | United Kingdom | 10.3 | 3 | Mexico | 16.8 |
| 4 | Mexico | 9.1 | 4 | West Germany | 12.7 |
| 5 | West Germany | 8.5 | 5 | United Kingdom | 12.5 |
| 6 | Netherlands | 7.7 | 6 | Taiwan | 11.2 |
| 7 | Saudi Arabia | 6.7 | 7 | South Korea | 7.1 |
| 8 | France | 5.9 | 8 | Hong Kong | 6.4 |
| 9 | South Korea | 5.7 | 9 | France | 6.0 |
| 10 | Belgium/Luxembourg | 4.9 | 10 | Italy | 5.5 |
| 11 | Taiwan | 4.4 | 11 | Indonesia | 5.3 |
| 12 | Australia | 3.9 | 12 | Brazil | 4.9 |
| 13 | Italy | 3.8 | 13 | Venezuela | 4.9 |
| 14 | Singapore | 3.7 | 14 | Nigeria | 3.7 |
| 15 | Spain | 2.9 | 15 | Saudi Arabia | 3.6 |
| 16 | Switzerland | 2.7 | 16 | Algeria | 3.6 |
| 17 | Venezuela | 2.7 | 17 | Netherlands | 3.0 |
| 18 | Hong Kong | 2.5 | 18 | Singapore | 2.9 |
| 19 | Brazil | 2.5 | 19 | Switzerland | 2.5 |
| 20 | China | 2.2 | 20 | Sweden | 2.4 |
| 21 | South Africa | 2.1 | 21 | Belgium/Luxembourg | 2.4 |
| 22 | Egypt | 2.1 | 22 | Netherlands Antilles | 2.4 |
| 23 | USSR | 2.0 | 23 | China | 2.3 |

[a] Chinese data are from IMF statistics; US data are from UN bilateral commodity trade statistics.

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goods sold in large volumes (see figure 3). Yet for low-volume goods, China's exports to the United States are becoming more diverse as China enters new product markets. Even so, US purchases are still more concentrated overall than those of China's major European trading partners. Germany, France, and England buy fewer textile and oil products and more foodstuffs, tools, and traditional Chinese products.

In spite of China's reliance on textile and oil products, its exports to the United States generally are more diversified than those of India, Argentina, Yugoslavia, and other countries at roughly comparable stages of development (see figure 4). In 1983, the variety of Chinese sales to the United States was about the same as that of South Korea.

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**Table 2**
**China: Trade With the United States, 1972-84** [a]

*Million US $, f.o.b.*

| | Total Trade | Exports | Imports | Trade Balance | Cumulative Trade Balance |
|---|---|---|---|---|---|
| 1972 | 92 | 32 | 60 | −28 | −28 |
| 1973 | 802 | 61 | 741 | −680 | −708 |
| 1974 | 931 | 112 | 819 | −707 | −1,415 |
| 1975 | 460 | 156 | 304 | −148 | −1,563 |
| 1976 | 337 | 202 | 135 | 67 | −1,496 |
| 1977 | 374 | 203 | 171 | 32 | −1,464 |
| 1978 | 1,189 | 324 | 865 | −541 | −2,005 |
| 1979 | 2,318 | 594 | 1,724 | −1,130 | −3,135 |
| 1980 | 4,814 | 1,059 | 3,755 | −2,696 | −5,831 |
| 1981 | 5,478 | 1,875 | 3,603 | −1,728 | −7,559 |
| 1982 | 5,187 | 2,275 | 2,912 | −637 | −8,196 |
| 1983 | 4,425 | 2,252 | 2,173 | 79 [b] | −8,117 |
| 1984 Jan-Jun | 2,644 | 1,482 | 1,162 | 320 | −7,797 |

[a] Data are from UN bilateral commodity trade statistics. 25X1
[b] Chinese customs statistics show a deficit in 1983.

**China's Imports From the United States**

Chinese purchases from the United States have fluctuated more than sales. They peaked at $3.8 billion in 1980, or 20 percent of China's total imports. By last year, US sales had dropped to $2.3 billion (see table 2), or 12 percent of China's total. The drop is largely due to declining purchases of US wheat, cotton, and textile fibers. Major trade items over the past decade have been grains, textile fibers (cotton and synthetic), fertilizers, wood, and plastics. In recent years, China increased purchases of US industrial machinery, office equipment, and commercial aircraft (see table 4).

China's imports of US goods have diversified considerably through early 1984 but still are much more concentrated than those of comparably developed countries—only East European imports, as illustrated by Yugoslavia in figure 5, are less varied. Because agricultural products are so dominant in Sino-US trade, China's imports of US goods also tend to be more concentrated than imports from Western Europe or Japan, which feature wide varieties of metallurgical products and manufactured goods.

**Trade Balances**

Bilateral trade imbalances are important to policymakers in both Washington and Beijing. Chinese purchases have exceeded sales to the United States in all but a few years. While both sides view the bilateral relationship in the context of overall trade, China presses the United States for balanced trade and has urged US officials to rectify the deficit. Trade and Finance Minister Chen Muhua raised the issue in May at the Joint Committee on Commerce and Trade meetings in Washington. She claimed a cumulative bilateral trade deficit of $12 billion for 1972-83; according to US trade statistics, the figure is closer to $8 billion (see table 2). One reason for this discrepancy is that the Chinese include some services and software in their trade statistics that do not register in US merchandise trade data. In addition, China lists imports c.i.f., thus including insurance and freight fees that are not included in the analogous US f.o.b. export data. 25X1

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Lower level trade officials periodically argue that continued deficits could force them to reduce imports of US goods in order to balance bilateral trade. We 25X1

**Figure 2**
**China: Exports to the United States, 1978-83**

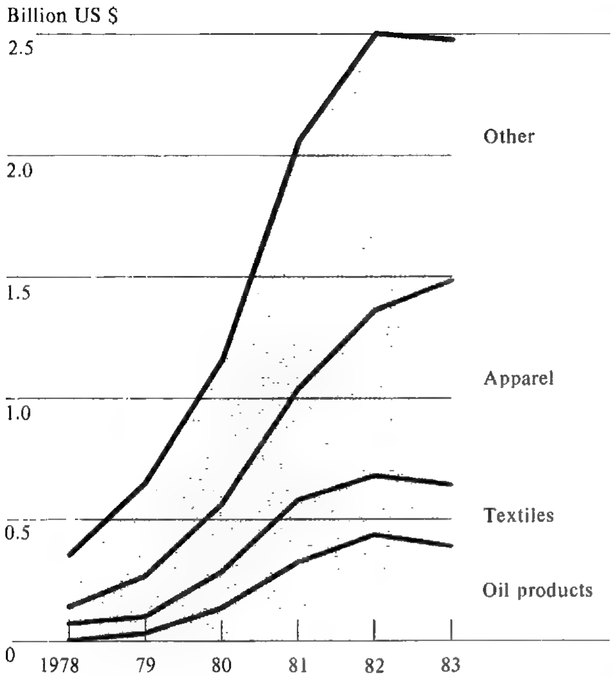


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**Table 3**
**Highlights of China's Exports to the United States, 1983** [a]

| Category | Value (*million US $*) | Share (*percent*) |
|---|---|---|
| **Total** | **2,243.8** | **100.0** |
| Manufactures | 1,025.8 | 45.7 |
| Apparel and accessories | 773.5 | 34.5 |
| Wicker, basketware | 57.7 | 2.6 |
| Footwear | 34.1 | 1.5 |
| Fuels | 429.6 | 19.1 |
| Gasoline | 308.9 | 13.8 |
| Crude oil | 78.6 | 3.5 |
| Intermediate manufactures | 390.4 | 17.4 |
| Textile yarn and fabrics | 240.7 | 10.7 |
| Chemicals, related products | 130.7 | 5.8 |
| Fireworks | 29.0 | 1.3 |
| Pharmaceuticals | 25.0 | 1.1 |
| Food | 111.8 | 5.0 |
| Canned vegetables | 34.5 | 1.5 |
| Tea | 9.9 | 0.4 |
| Crude materials | 97.4 | 4.3 |
| Barium sulfate and carbonate | 26.2 | 1.2 |
| Down and feathers | 7.7 | 0.3 |
| Machinery, transport equipment | 42.2 | 1.9 |
| Miscellaneous | 10.2 | 0.5 |
| Beverages and tobacco | 4.2 | 0.2 |
| Beer | 2.4 | 0.1 |
| Animal/vegetable fats, oils | 1.6 | 0.1 |

[a] Data are from US Customs Bureau; totals may differ from IMF and UN data in tables 1 and 2 due to differences in exchange rate conversions and commodity coverage. US imports are valued on a free alongside ship (f.a.s.) basis.

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believe that the Chinese try to use the deficit issue primarily to pressure commercial interests to buy more Chinese goods and political interests to reduce restrictions on Chinese exports. However, because China maintains offsetting trade surpluses with other countries, the deficit argument itself carries little economic merit.

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Indeed, the Chinese are quite willing to use trade as leverage in economic disputes and have become increasingly skillful in manipulating American industry pressure on Washington policymakers. For example, in 1983 they embargoed a few US products in retaliation for US import restraints on Chinese textiles.[2] At the same time, Chinese buyers privately told US traders in the forest products, agriculture, and possibly other sectors that those products were vulnerable as well. The resulting outcry from those industries complemented China's diplomatic opposition to the demands of US textile and apparel producers for tighter quotas.

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[2] The Chinese selected the embargoed categories—synthetic fibers, cotton, soybeans, and, later, wheat—carefully. They already had ample supplies of most of the affected products, had already reduced purchases of cotton, believed US wheat prices were too high anyway, and could fill any remaining requirements from other suppliers or from US companies through third parties.

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**Figure 3**
**Changes in the Diversity of China's Exports to the United States, 1980-83**

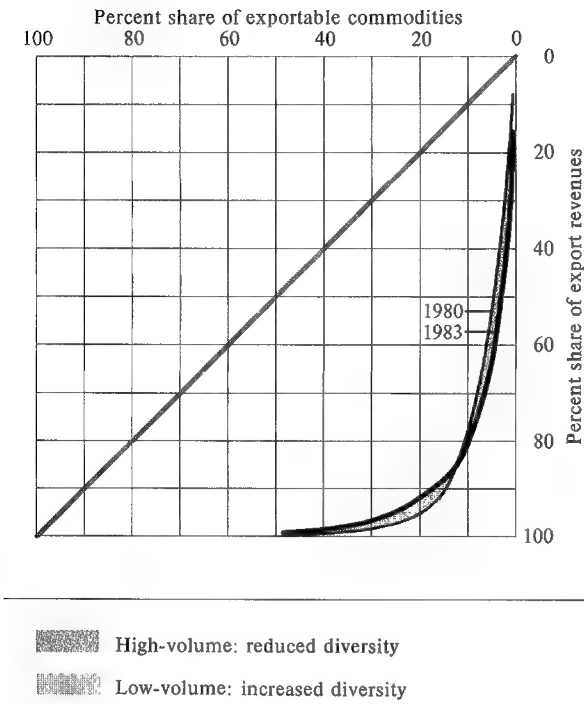


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**Table 4**
**Highlights of China's Imports From the United States, 1983** [a]

| Category | Value (*million US $*) | Share (*percent*) |
|---|---|---|
| **Total** | **2,173** | **100.0** |
| Machinery, transport equipment | 586 | 27.0 |
| Aircraft and parts | 235 | 10.8 |
| Construction, mining equipment | 52 | 2.4 |
| Office equipment | 54 | 2.5 |
| Food | 541 | 24.9 |
| Grain | 536 | 24.7 |
| Chemicals | 354 | 16.3 |
| Fertilizers | 168 | 7.7 |
| Plastics | 92 | 4.2 |
| Crude materials | 300 | 13.8 |
| Conifer logs | 228 | 10.5 |
| Manufactures | 220 | 10.1 |
| Aluminum | 87 | 4.0 |
| Paper | 41 | 1.9 |
| Miscellaneous | 172 | 7.9 |
| Electrical meters, controls | 92 | 4.2 |

[a] Data are from US Customs Bureau. US exports are valued on a free on board (f.o.b.) basis.

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### Evolving International Trade Ties

China is becoming more active in the world economic scene, expanding its trade and investment linkages and participating more in international economic organizations. Its higher profile has attracted the interest of foreign firms and forced, albeit very slowly, Chinese accommodations to standard international business practices. We believe a prime area of potential trade growth over the next decade will be that evolving from direct ties between foreign and Chinese firms, such as joint ventures, coproduction, and cooperative project development. These arrangements generate both imports—technology, materials, and equipment—and exports.

Over the past five years the Chinese have undertaken several steps to increase foreign participation in their economy through trade and investment:

- Opened 19 coastal sites to foreign investment, offering more liberal business terms than offered elsewhere in China.
- Passed laws governing taxation, liability, patent protection, trademarks, and investment procedures for foreign firms.
- Expanded the array of products of joint Chinese-foreign firms that may be marketed within China.
- Held many investment conferences to publicize hundreds of projects for which the Chinese want Western technology, equipment, capital, management, and marketing.
- Negotiated tax, investment, and other cooperation accords with several countries to clarify such issues as expropriation policy, arbitration procedures, repatriation of profits, and labor compensation.

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**Figure 4**
**Selected Countries: Comparison of the Diversity of Imports From the United States**

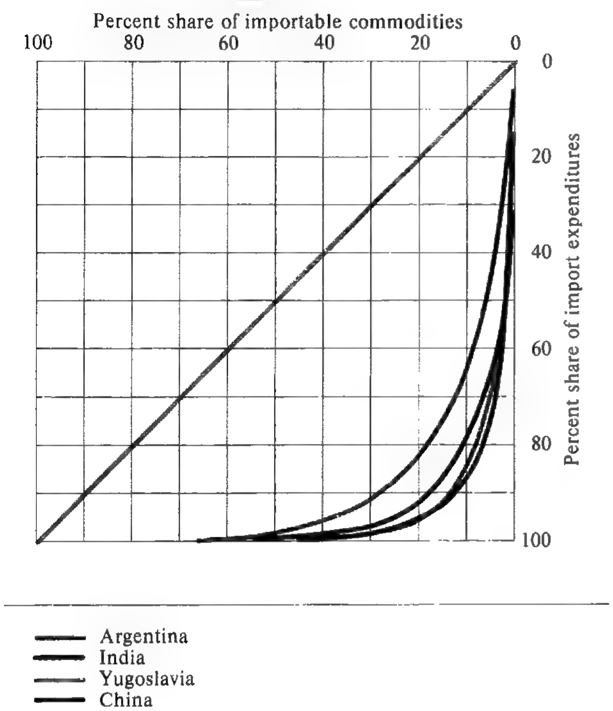


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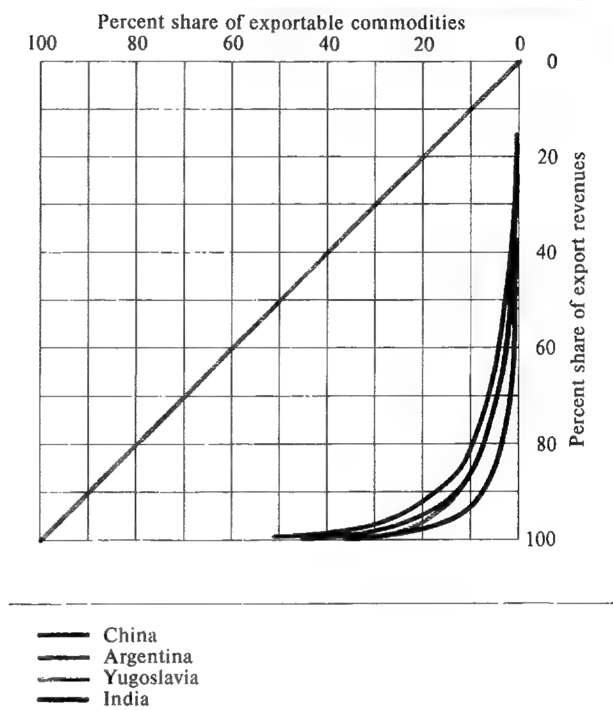
**Figure 5**
**Selected Countries: Comparison of the Diversity of Exports to the United States**

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**US Investment in China**

US firms have established nearly two dozen joint ventures, one wholly owned subsidiary, and countless cooperative arrangements (licenses, compensation trade, assembly or processing accords, and buy-back deals) in China since 1979. According to the Ministry of Foreign Economic Relations and Trade, US investment in equity joint ventures was about $85 million at the end of 1983.[3] In addition, US firms are involved extensively in China's search for offshore oil, with contracts costing US companies about $300 million. Together with cooperative arrangements, we estimate that US investment in China now totals approximately $500 million. By contrast, Occidental's contract, signed this spring, to develop coal mines at Ping-shuo will cost the participating US firms about $350 million.

More than 150 American companies now have offices in Beijing, Shanghai, or Guangzhou. Many firms are reluctant to become more deeply involved, however, largely because of the fluid nature of Chinese laws governing—and protecting—foreign investment. In addition, potential new entrants may not be willing to accept the early losses some firms have taken in order to better take advantage of future business opportunities. Finally, firms already engaged in business in China discourage others with tales of poor business and residential facilities, bureaucratic confusion, higher-than-expected costs, and arbitrary assessment of customs duties. Although such complaints generally are valid, we suspect some businessmen exaggerate them to dishearten potential competitors.

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[3] Statistics vary depending on the source of funds, the type of venture, the exchange rate, and whether one is measuring commitments or actual expenditures.

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Over time, operating conditions will improve as China gains experience with Western business practices and refines its legal and bureaucratic structures and as Western businessmen adjust their expectations. According to press reports, more than half of all of China's equity joint venture contracts were signed in 1983, suggesting that investor confidence had increased. An active campaign by the Chinese leadership to encourage foreign investment appears to have helped. The exchange of visits by Premier Zhao Ziyang and President Reagan early this year underscored the positive bilateral relationship and reassured the American business community. Nonetheless, the level of new US investment in China this year remains to be assessed.

**Seeking To Diversify Exports**

China's early forays into export expansion have focused on improving, packaging, and marketing traditional light industrial products. Early 1984 trade statistics suggest a growing export capability in such product groups as toys, collectibles (coins, antiques), housewares (wicker, china, plasticware), and chemicals. The Chinese, especially through joint foreign-Chinese firms, are actively searching for additional marketing opportunities.

There is scant detailed information on China's future export plans, but information from the press and from US and other industrialists suggests that China has expansive long-term goals. Vice Premiers Tian Jiyun and Li Peng separately announced in July that China gradually will become an exporter of grains, cotton, and edible oils.[4] China has boosted productivity, and favorable growing conditions already have permitted sales of cotton and corn. Nevertheless, we believe that weather-related growing conditions will fluctuate in the future and that the needs of China's growing population will work against volume export of unprocessed agricultural products

China's long-term economic plans apparently include substantial growth in machinery and equipment exports as well. Beijing already exports such machinery as basic machine tools and small hydropower generators. Various ministries, corporations, factories, and provinces have developed at least tentative plans to upgrade their manufacturing facilities and to improve output quality in order to become competitive in world markets within the next five to 15 years. Specific products include machine tools, automobile parts, trucks, process controls, chemicals, and nuclear power plants. China is pushing electronics development in particular, driving to double by 1990 the output of semiconductors, communications equipment, computers, and consumer electronics for both domestic use and export. 25X1

As China's exports expand, they will repeatedly encounter trade barriers. US, Japanese, and European authorities already have imposed extra import duties 25X1
or other limitations on some Chinese exports. China's economic reforms stimulated some of these problems. Decentralization of trade responsibilities and emphasis on profitability thrust factories and local trade organizations into unfamiliar international trade activities. Consequent underpricing of some goods in world markets resulted in antidumping investigations and duties. 25X1

A tightening of trade authority in early 1984 will help eliminate some of the confusion. Nonetheless, China 25X1
will continue to push into world markets whenever possible, and increased Chinese exports coupled with protectionism among major importing countries promise to produce additional frictions. Even though China rejects trade restrictions as antithetical to free trade, the government has reluctantly cooperated with antidumping investigators. Nonetheless, we expect Beijing to remain highly sensitive to trade restrictions and to work with other developing exporters, particularly within the GATT framework, to force less constrained world trade 25X1

To reduce the chances of triggering the protection mechanisms of importing countries, China tries not 25X1
only to diversify its product array but also its markets. This has been particularly true of textiles and apparel because they account for such a large share of China's export earnings that Beijing cannot afford simply to reduce sales. During the tough textile negotiations

[4] We assume this means exports in addition to China's normal aid to LDCs.

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with the United States in 1982-83, China approached several nations—including Australia, Brazil, the USSR, and those in Eastern Europe—for additional textile sales, with only minor success.

We believe China's attempts to expand exports to alternative markets will not relieve trade pressures with the United States and other developed importers. Increased trade with the USSR and Eastern Europe would be largely on a barter basis. Other potential customers are developing countries that compete with China in exporting sensitive categories of goods—such as textiles or footwear—to OECD markets and would not import those goods from China. Consequently, the United States and other OECD countries will continue to be China's main buyers, with all the potential for friction that entails.

**Diversifying Imports**

China's interests in industrial advancement, export development, and self-reliance will stimulate new import patterns. During the next few years, we expect capital goods and software—designs, blueprints, and training—to constitute a greater share of Chinese imports, while the share taken by agricultural products ebbs.

China has more than 300,000 industrial enterprises that need at least some capital improvements and massive infrastructural development. More than $16 billion in foreign exchange reserves (excluding gold holdings) and additional billions in untapped foreign loans have long suggested an imminent ground swell in capital imports. However, Beijing is wary of another massive surge in plant and equipment purchases like the 1978 binge that led to contract cancellations and embarrassment. Thus many projects to upgrade factories are being undertaken with foreign investment and advice or under the auspices of Western assistance programs. Cumbersome decisionmaking processes, extensive negotiations, unrealistic demands on foreign firms, and time-consuming feasibility studies are slowing the expected pace of equipment purchases.

Many of China's more massive development projects are ultimately aimed at import substitution. Over the past decade, China has imported plants, equipment, and technology in order to boost domestic production of many imported products, led by fertilizers, synthetic fibers, and steels. Agricultural reforms also were designed to bolster production and decrease dependence on imports. even China's joint venture policy now calls for projects that stress import substitution as opposed to exports.

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Partly because of the agricultural reforms and also because of good crop conditions, China has enjoyed four successive years of record harvests that lowered imports of cotton, wheat, and soybeans. For most industrial products, however, rapidly expanding consumption or unexpectedly slow completion of new facilities have frustrated Beijing's attempts at import substitution. Nonetheless, import substitution has slashed the growth rate of purchases of industrial materials. For example, we estimate that by the end of the decade China's urea output may reach 4 million tons, about the level of 1983 production plus imports. Polyester output should at least double the 1983 level of production plus imports. Although we expect demand to continue rising, import growth should be at slower rates than during the late 1970s and early 1980s.

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The Chinese also try to diversify their imports from the United States and other countries by seeking alternative suppliers. And Chinese traders play world markets astutely. Although some orders are placed in the name of friendship or international good will, most are based on favorable price, quality, and financing arrangements. At the same time Beijing wants to avoid being dependent on one supplier for particular products. Chinese negotiators show great skill enticing firms to bid on projects and then playing the firms against one another.

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Concessional financing and transfer of know-how are important criteria in China's selection of suppliers of capital equipment and industrial processes. The Chinese want the latest technologies and, as senior policy adviser Huan Xiang indicated last August, they believe the United States will be the world leader in high technology for some time to come. Even so, China also

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purchases used, less technologically advanced plants, such as those shut down during the recession of 1982, and has contracted with international investment firms to find and buy even more used plants and equipment (see table 5).

China also seeks commercial ties with newly industrializing countries, both to cement political relations and to exploit the nascent technical strengths of those nations' industries. Ties to Brazil, for example, have increased substantially in the last few years. China has purchased industrial machinery from Brazil, and in May 1984 the two countries signed protocols covering technical exchanges and cooperation in industrial development, hydropower, and nuclear energy. China is establishing similar arrangements with several other Latin American, Middle Eastern, and Southeast Asian countries.

**Table 5**
**China: Selected Purchases of Used Factories**

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| Type of Factory Purchased | Country of Origin |
|---|---|
| Aluminum extrusion plant | United States |
| Industrial sewing machine plant | Italy |
| Steel products mill | United States |
| Semiconductor line | United States |
| Textile dyeing mill | Federal Republic of Germany |
| Textile spinning mill | United States |
| **Other deals still under discussion** | |
| Fiberboard plant | United States |
| Ethylene plant | Japan |

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## Outlook for US-China Trade

### Prospects for US Firms

Prospects are mixed for long-term involvement in China by US firms. The Chinese generally prefer US technology and industrial equipment. But US firms are handicapped somewhat by the lack of concessional financing and by delays in agreement on or implementation of bilateral pacts regarding taxes, investment, nuclear and other technology controls, and other pertinent business facilitation accords.

Nonetheless, the outlook for US investment is good. So far, Chinese officials are disappointed by the reluctance of American companies to invest in China, but we expect the pace to pick up, especially once a bilateral investment treaty is concluded.[5] Beijing is authorizing more jurisdictions to negotiate foreign investments directly, and US firms will doubtless be involved. Most such projects will likely be relatively small, however, and may prove profitable but not lucrative to the average investor.

In contrast, such large-scale Sino-US projects as the Ping-shuo coal deal are likely to be few in number. Because of the size and complexity of this type of project, China can overestimate its ability to meet contractual obligations for infrastructure and other support; financing acceptable to the Chinese can be difficult to arrange; and unfavorable market changes during the prolonged development period can undermine plans to export the product. Other events, though not necessarily directly related, will strongly influence the prospects for future large projects. For instance, if oil companies do not find major offshore deposits within the next few years, their financial losses will dampen the investment environment. 25X1

In addition to increasing potential for US investment in China, we believe opportunities for sales of equipment and industrial raw materials will also expand. China has a continuing need for foreign expertise, technology, and equipment to modernize old industries and develop new ones. In the wake of last year's liberalization of technology controls, some observers speculated that US technology sales could reach $2 billion in 1984 alone. We believe that, although contracts may reach $2 billion this year, that amount would not necessarily be reflected in 1984 US trade statistics because shipments, which could be drawn out over several years, do not register as exports until they pass through US Customs. 25X1 25X1 25X1

[5] Negotiations will probably resume next spring. 25X1

We believe that China would like to have US assistance or involvement in nearly every economic sector (see table 6). In addition to outright, one-time purchases, an increasing share of Sino-US trade stems from long-term or recurrent supply relationships. Joint ventures and other investments will generate continuing sales of equipment and raw materials to China; one American businessman asserts that an important attraction to China is not the investment project per se, but the promise of prolonged future sales.

China also will continue to need certain industrial raw materials in spite of plans to replace imports by expanding domestic capacity. American firms are likely to be a major source of imported phosphate, urea, and compound fertilizers, for instance, as well as other chemical raw materials whenever world prices are depressed. The United States probably will continue to account for a large share of China's timber imports.[6] We expect Chinese imports of US grains to continue, too, though at a level lower than the 6-million-ton-per-year minimum of the grain trade agreement that expires this year.

In our judgment, services will be an important growth sector in China during the next decade and American firms will contribute to that growth. Tourism, leasing, engineering, and project design already are expanding rapidly. We expect China to contract for additional consultancies or joint ventures in these and such other fields as finance, insurance, and market research.

Two other categories will highlight US exports to China in the coming years. We expect sales of defense equipment and technologies to gain importance now that China is eligible for foreign military sales. The Chinese already are negotiating with manufacturers for several weapon systems. Finally, shipments of products from firms in the United States that are at least partly owned by the Chinese are likely to rise. So far, China has acquired part ownership of a few small electronics firms to bolster its technological development and has purchased some large stands of timber to guarantee availability in the event of future tight markets.

**Table 6**
**China: Sectors With High Potential for Commercial Links With the United States**

| |
|---|
| Energy<br>Oil<br>Coal<br>Hydropower<br>Nuclear power<br>Transmission<br>Conservation |
| Communications<br>Satellite<br>Telephone<br>Fiber optics |
| Building materials and methods |
| Packaging |
| Weapon systems |
| Transportation<br>Air<br>Rail<br>Road<br>Tires, parts<br>Traffic control |
| Agriculture<br>Food processing<br>Agricultural equipment<br>Agricultural chemicals |
| Computers/electronics |
| Plastics/synthetic materials |
| Pollution control systems |
| Quality control systems |

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Although US exporters look forward to increased sales to China, several have expressed concern that expanded Chinese exports will compete with US products in third-country markets. Some firms refuse to sell technologies to China for fear of creating a future competitor. We expect China to develop export capabilities in many products, but generally at neither the volume nor the level of sophistication available from healthy Western businesses. 25X1

25X1

We believe the Chinese will not be able to absorb technologies fast enough for finished manufactures to become a significant share of exports within the next decade or so. China's ability to absorb technologies

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has been circumscribed by a shortage of skilled personnel, lack of incentives for plant officials and planners, poor planning and prioritization, and other factors. We believe that Chinese industries will progress technologically, but their average technical level will continue to lag that of the developed world.[7] [redacted]

It is likely, however, that China will substantially expand component assembly operations under the auspices of Western firms. Machine tool sales, particularly of those tools that are of relatively uncomplicated designs and require predominantly hand machining and assembly, probably will increase. Exports of such small manufactures as hand tools, spare parts, and industrial fasteners also are likely to show rapid growth. Some of these products could displace the sales of US firms, but no more so than similar exports already coming from Pakistan, Taiwan, South Korea, and others. [redacted]

Beijing is trying to increase the area planted in cotton and oilseeds, which may cause problems for American farmers. Since world textile quotas will limit the amount of cotton products China can export, we expect raw cotton exports to rise. China already sells a small amount of cotton and, according to international traders, offered larger-than-normal amounts for sale this spring. The Chinese should be able to export cotton competitively if they can conform to world standards in terms of quality and bale size. China may also be able to export more soybeans and soybean products. Over the next few years, Japanese soybean importers intend to switch some purchases to China from the United States in order to diversify their sources; Chinese soybean producers intend to buy modern presses in order to produce export-quality soybean oil and meal. China will likely push sales of soybean products to Japan as other exports, such as oil, decline. [redacted]

Chinese coal is another commodity generating concern among US suppliers, who worry that Chinese coal will displace their sales in Japan and possibly elsewhere in Asia. We expect China to remain a relatively minor exporter of coal because of the primary role coal plays in meeting China's energy

[redacted]

needs.[8] Exports from its joint ventures nevertheless may displace others in the Japanese market. The major threat to US coal exports is more likely to come from Australia, which sells Japan three times as much coal as the United States and 10 times as much as China. [redacted] 25X1

### Chinese Exports to the United States

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We expect Chinese exports to the United States a decade from now to strongly resemble the current array. Textiles will continue to be China's principal source of foreign exchange. If oil production declines, oil exports may have to be diverted to fill domestic needs and, together with tightening restraints on textiles, may slow the rate of growth in China's exports. The fastest export growth will probably be in sectors under development now: foodstuffs, chemicals, small machinery, housewares, consumer electronics, and metal products—all industries now undergoing expansion, largely in cooperation with foreign firms. 25X1
[redacted] 25X1

Much of recent sustained export expansion can indeed be traced to relations with foreign firms, particularly compensation trade links established in the late 1970s. Chinese pharmaceutical exports, for example, have gone from $4.7 million in 1979 to $25 million in 1983, an average annual increase of more than 50 percent. Similarly, sales of toiletries were $6.6 million in 1979 and averaged 23-percent annual growth to reach $15 million last year. These product lines are still being expanded with additional Western investment in everything from traditional herbal medicines to genetic engineering, promising continued strong growth. [redacted] 25X1

## Trade Policy Issues

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### Market Access

We believe that market access will be the preeminent Sino-US trade issue over the next few years. China will complain about any real or perceived barriers to

[redacted] 25X1

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trade with the United States. However, unless bilateral relations deteriorate considerably, we do not believe Beijing will elevate trade disputes to a level that could affect overall relations. Still, the Chinese could repeat the 1983 embargo in reaction to particularly offensive US actions to underscore their concern about trade limitations. Nonetheless, Chinese exports will persistently test those barriers. The result will be recurrent antidumping complaints and consultations on trade levels and US import duties.[9]

Among its current complaints, China wants the United States to review its trade laws to eliminate obstacles to closer economic ties. Restrictions on textile trade have caused considerable diplomatic tension, and restraints on technology exports, although liberalized, have sent the Chinese to other countries for some purchases.

In fact, one purpose of Zhao Ziyang's trip to Europe this year was to encourage technology trade with the European Community.

In addition to restrictions on textile and technology trade, China objects to Export-Import Bank (Ex-Im) provisions restricting loans to Communist countries (a presidential waiver is required for credit to a Communist nation and for any loan exceeding $50 million) and to being excluded from duty-free treatment of trade under the Generalized System of Preferences. Changes in US customs procedures, such as the recategorization of gasoline into a higher tariff classification, also irritate the Chinese. 25X1

Restrictions on Chinese access to US textile markets will remain a highly publicized irritant. Refinements in US methods to determine market penetration and identify country of origin have driven the textile exporting nations, including China, together to press in international venues for more liberal textile trade. China now has joined not only the Multifiber Arrangement, GATT's textile trade monitoring body, but also the new Textile and Apparel Bureau, a group of exporters who hope to work with consumers and retailers to pressure US and European policymakers to relax textile trade constraints. Chinese and US interests will clash on these issues without mutually satisfactory resolution for many years. 25X1 25X1

China also will seek GATT membership, with expanded market access as one goal. While China may only accept accession terms that conform to its trade plans, we believe that agreements to control surges in Chinese exports, to provide trade and economic data, or to sign GATT nontariff barrier codes are possible. 25X1 By acceding to GATT, China would meet the final legal requirement for US Generalized System of Preferences (GSP) status. 25X1 With GSP, China would qualify for lower import tariffs, thus reducing costs and enhancing their competitiveness in the US market. But first, careful and possibly prolonged negotiations for accession to GATT must be completed. 25X1

**Financing**

US firms seeking entree into the China market will face strong competition from European and Japanese firms, which can more readily arrange financing at concessional rates. 25X1 The Overseas Private Investment Corporation (OPIC) has financed feasibility studies and insured several projects, but OPIC does not provide large-scale financing. Although Ex-Im loans can be obtained for Sino-US transactions, the Bank's rates are not presently competitive with government-backed loans available from Japan, Belgium, and others. 25X1

[9] For example, one new joint venture could ultimately export aluminum foil at prices that significantly undercut US producers. 25X1